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RUEHPE/AMEMBASSY LIMA PRIORITY 2757
RUEHMD/AMEMBASSY MADRID PRIORITY 1810
RUEHGL/AMCONSUL GUAYAQUIL PRIORITY 3744
RUEHRI/AMCONSUL RIO DE JANEIRO PRIORITY 0049
RUEHSO/AMCONSUL SAO PAULO PRIORITY 0206
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C O N F I D E N T I A L QUITO 000764

SIPDIS

TREASURY FOR MEWENS
DEPT FOR WHA/EPSC FAITH CORNEILLE

E.O. 12958: DECL: 08/20/2018
TAGS: EPET EINV ECON EC
SUBJECT: GOE NEGOTIATING OIL CONTRACTS - AGAIN: FIRMS AGREE TO USE SERVICES MODEL

REF: A. QUITO 351
¶B. QUITO 681

Classified By: Ambassador Heather Hodges, Reasons 1.4 (b) and (d).

¶1. (U) Summary: President Correa held high level talks with the leaders of international oil companies to restart oil contract negotiations after he had suspended them in April. Chinese, Spanish, and Brazilian oil companies have agreed on the framework for new production contracts and to a transition to a services contract model. In a separate development, U.S. oil company City Oriente turned its concession over to Petroecuador on August 1 and received 95% of a $69 million payment August 7. End Summary.

¶2. (C) President Correa met August 7-8 with the heads of three of the four main foreign oil companies operating in Ecuador - Andes (Chinese), Repsol (Spanish), and Petrobras (Brazilian). All three apparently agreed on the framework for new production sharing contracts and to transition to services contracts. A meeting between Correa and Perenco (French), the fourth oil company currently operating under a production sharing contract, has yet to take place. (Murphy, a U.S. company, is a minority partner in the Repsol consortium, while another U.S. company, Burlington, is a minority partner in the Perenco consortiums.)

¶3. (C) Oil contract renegotiations between the GOE and the foreign producers were suspended by Correa in April (reftel a). Petroleum company sources report that when Correa unexpectedly terminated negotiations, they had been close to agreeing with Petroleum Minister Chiriboga on the key economic provisions for new production sharing contracts. Correa reportedly suspended the talks because they did not include a clear timeframe or plan to transition towards oil services contracts. Correa has expressed a strong preference for the services contract model, since that would allow the GOE to capture the benefits of price increases and retain control over the oil. However, the government's initial model services contract was roundly rejected by the oil companies, and in June, Repsol and Perenco stopped paying an extraordinary income tax imposed by the government.

Contract Basics

¶4. (C) Repsol and Murphy both told econoff that they are pleased that negotiations have restarted, and provided some information on the provisions discussed with Correa. They reported that the proposed new production sharing contract is basically the same as what Repsol and its consortium members had negotiated before the April suspension. As noted in reftel a, one of the key provisions in the new production sharing contracts would be some relief from the windfall income tax by raising the reference price above which "extraordinary revenue" must be shared with the state. The new agreement would also reduce the government's share of extraordinary income from 99% to 70%. For the Repsol/Murphy consortium, the new reference price would be $42.50/barrel, compared to the current $25/barrel. In the suspended April negotiations, the reference price had been $45.50, so the companies conceded a bit on this point in their discussions with Correa. (Note: According to rough Embassy calculations, based on prevailing oil prices, Repsol's income per barrel would be roughly the same under the notional new contract as under the current 50% windfall tax.)

¶5. (C) The international arbitration provisions established in the contract was a sticking point in the previous discussions, and had not been resolved when talks were suspended in April. The GOE has repeatedly insisted that it would not accept international arbitration before the World Bank's ICSID. Correa instead is now proposing arbitration under UN rules (UNCITRAL) to be held in Chile. The international oil companies appear to be willing to accept UNCITRAL arbitration.

¶6. (C) According to the Repsol and Murphy representatives, Correa was clear that he expects the consortium to move quickly to a services contract, although he did not provide specifics on how it would be structured. The companies believe a services contract could be workable, but noted that negotiating one is complicated. A major sticking point will be reimbursing the companies for their expenses. (Under a production sharing contract, the companies absorb the investment and operating costs out of their production share, while in a typical services contract the companies are paid a per barrel service fee, and the government absorbs the operating and investment expenses.) Most critical is the question of how to reimburse the companies' unamortized investments accrued under their current production sharing contracts. Repsol has $700 million in unamortized investment in Ecuador, and would prefer an upfront payment from the GOE. However, it is likely the GOE would ask for some type of payment plan over time as paying off each company's investment up front would be too costly.

City Oriente Departs Ecuador

¶7. (C) On August 1, City Oriente, a small U.S. oil company, turned its concession over to Petroecuador in return for a $69 million payment from the GOE as compensation for its unamortized investments (reftel b). Ninety-five percent of the amount has been paid, with a final payment scheduled for the end of November. City Oriente had been offered the option of remaining in Ecuador under a services contract, provided it was willing to accept compensation over time for its unamortized investment. It preferred to take the cash and leave.

COMMENT:

¶8. (C) President Correa has once again changed course in his relations with the petroleum sector, the fifth abrupt change in his tenure. Petroleum sector representatives believe that the GOE was pushed back to the negotiating table when Repsol and others filed for arbitration and stopped paying the government's 99% windfall profits tax. In fact, Repsol is no longer paying even the 50% share required by law. Another expert believes the GOE is learning that state-owned Petroecuador, which is corrupt and inefficient, is unable to

exploit even its own oil fields, as evidenced by flat production in spite of increased investment. Therefore the GOE recognizes the need for private companies to renew investment as soon as possible to maintain and possibly increase total petroleum production. Although Correa wants to immediately switch to service contracts, it will likely take some time to iron out the details of this type of agreement and the transition could be lengthy.
Hodges